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SUBJECT: AMBASSADOR'S INTRODUCTORY CALL AT NATIONAL BANK OF
AZERBAIJAN

1. SUMMARY: During the Ambassador's July 28 introductory call on National Bank of Azerbaijan (NBA) President Elman Rustamov, Rustamov said Azerbaijan's year-to-date growth hovered around 40%, while inflation over the last six months was nearly six percent. Rustamov reviewed the progress that Azerbaijan has achieved in the economic and banking sectors, but admitted that much work needs to be done. Rustamov said that economic reform will act as a catalyst to political reform and because of this pursuing economic reform is important. END SUMMARY.

2. During a July 28 meeting the National Bank of Azerbaijan President Elman Rustamov briefed the Ambassador on Azerbaijan's recent economic growth. He reported that Azerbaijan has seen approximately 40 percent growth in its overall economy and 90 percent growth in the energy sector. He also said that the 2006 budget will increase by approximately 90 percent. The level of foreign currency held in the central bank has doubled (time period not stated). He said that over the past six months inflation has been six percent. Rustamov reported that of the entire finance sector, 90 percent is in the banking sector.

3. Despite the rapid economic growth in Azerbaijan, there were still no foreign banks in Azerbaijan that did significant business. Rustamov said that foreign banks were welcome in Azerbaijan, and seemed perplexed as to why more foreign banks were not operating in Azerbaijan. He then agreed with the Ambassador that this was likely the result of what is viewed by potential banks as a poor business and legal climate. Rustamov laid out the following priorities for the NBA in the coming years: ensuring financial and macroeconomic stability through better coordination of macroeconomics policy, increased transparency in the banking sector, strengthening of the national bank so it can have the modern, classical functions of a central bank, solving the basic problems of the banking sector and privatization of banks. Rustamov said that with the continued cooperation of the World Bank, European Bank for Reconstruction and Development, and USAID, that the path of liberal reforms that has been started in the banking sector will continue.

4. Rustamov was proud to report that Azerbaijan has the best electronic payment system amongst the CIS countries. He also mentioned that the "postal bank" project and microcredit are two important projects for the regions of Azerbaijan that will make a big difference in the lives of ordinary people. Rustamov said that these are only two areas where the banking

sector is having positive impacts on other sectors of the economy. Additionally, the NBA has established banking programs at a university in Baku.

¶5. On the negative said, Rustamov said that there remains a very large informal economy in Azerbaijan, which hinders some reform efforts. For example, one of the reasons that the recently passed law on mortgages has not been successful is because while most people have enough income to qualify for the mortgage, they do not have enough legal income that can be officially verified, which results in a large number of individuals not qualifying for a mortgage. Rustamov said that while NBA was currently involved in the mortgage process, this function would be separated from the Central Bank on one or two years.

¶6. (SBU) COMMENT: The NBA's ability to manage fiscal policy will be key to the GOAJ's ability to stave off inflation and Dutch Disease over the next few years. The weak overall banking sector, combined with a recent GOAJ decision to nearly double the 2006 budget (septel) make the NBA's task all the more difficult. END COMMENT.
HYLAND